



CA FOUNDATION

The Institute of Chartered Accountants of India

BUSINESS LAWS & BUSINESS CORRESPONDENCE
& REPORTING



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Indian Contract Act, 1872.

Introduction

The law of contract in India contained in Indian Contract Act 1872, which is based on English common law. It extends to whole of India except the state of Jammu and Kashmir. It came into force on the first Sep. 1872.

Definitions u/s 2 of the Indian Contract Act, 1872

An agreement to become a contract must give rise a legal obligation.

| Sections | Defines for | |
|----------|------------------|--|
| 2(a) | Proposal / offer | When one person signifies to another, his willingness to do or to abstain from doing anything, with a view to obtaining the assent of that other to such act or abstinence, he is said to make a proposal. |
| 2(b) | Promise | When the person to whom the proposal is made signifies his assent thereto, the proposal is said to be accepted. A proposal, when accepted, becomes a promise. |

| | | |
|------|-----------------------|---|
| Q(c) | Promisor and Promisee | The person making the proposal is called the "promisor" and the person accepting the proposal is called the "promisee". |
| Q(d) | Consideration | When, at the desire of the promisor, the promisee or any other person has done or abstained to do or to abstain from doing, something; such act or abstinence or promise is called a consideration for the promise. |
| Q(e) | Agreement | Every promise and every set of promises, forming the consideration for each other, is an agreement. |
| Q(f) | Reciprocal Promises | Promises which form the consideration or part of the consideration for each other are called reciprocal promises. Reciprocal promises requires both the parties to the agreement to do something. |

| | | |
|------|-------------------|--|
| Q(g) | Void Agreement | An agreement not enforceable by law is said to be void |
| Q(h) | Contract | An agreement not enforceable by law is is a contract |
| Q(i) | Voidable Contract | An agreement which is enforceable by law at the option of one or more of the parties thereto, but not at the option of the other or others, is a voidable contract. The contract will be void if the party having the option do not make it valid. |
| Q(j) | Void Contract | A Contract which ceases to be enforceable by law becomes void when it ceases to be enforceable |

Essential Elements of a Valid Contract -

- (i) In order to constitute a contract, there must be an agreement in first place.
- (ii) According to Sec. 14, 'Consent is said to be free when it is not caused by coercion, undue influence, fraud, misrepresentation or mistake'.

- (*) The agreement must be supported by a lawful consideration. Consideration means 'something in return'.
- (*) The parties to an agreement must be capable of entering into a contract. A person is considered competent if he is (a) eighteen years of age (b) of sound mind (c) not disqualified from contracting by any law to which he is subject.
- (*) There must be legality of object and consideration. Failing which it will not be a valid contract.
- (*) The parties must intend to create a legal relationship. Agreements of social or domestic nature do not contemplate legal relationship, so they are not contracts.
- (*) The agreement not expressly declared void or illegal by law.
- (*) The terms of agreement is such that it requires compliance of certain formalities, such requirement should be fulfilled.

Classification of Contracts:

| Based on enforceability | Based on Method of formation | Based on extent of performance | Based on obligation | on the basis of mode of creation |
|-------------------------|------------------------------|--------------------------------|-------------------------|----------------------------------|
| (*) Void Contract | | | | |
| (*) Void Contract | Formal Contract | (*) Executed Contract | (*) Unilateral Contract | Express Contract |
| (*) Voidable Contract | Simpliciter Contract | (*) Executory Contract | (*) Bilateral Contract | • Implied or |
| (*) Void Contract | | | | |

| | | | | |
|-------------------------|--|--|-----------------------|-------------------|
| Unenforceable Contracts | | | Multilateral Contract | Inferred Contract |
| Illegal Contract | | | | (*) E-Contract |

Offer:

An offer is an expression of willingness to contract on certain terms, made with the intention that it shall become binding as soon as it is accepted by the person to whom it is addressed, the "offeree".

Types of offer -

(*) Express and Implied offer - An offer, which is made by words, is called express offers and the one, which is inferred from the conduct of a person or the circumstances of the case, is called an implied offer.

(*) offer and Invitation to offer - In the case of invitation to offer the person sending out invitation does not make an offer but only invites the other parties to make an offer.

(*) offer can be specific or general → An offer is said to be specific when it is addressed to a definite person or persons to whom it is made. A general

offer on the other hand is addressed to public in large and may be accepted by anybody fulfilling the terms and conditions.

Rules Regarding offer:

- (i) offer may be expressed or implied.
- (ii) offer may be specific or general.
- (iii) offer must give rise to legal obligation.
- (iv) Terms of an offer must be definite and certain.
- (v) offer must be distinguished from an invitation to offer.
- (vi) offer must be made with a view to obtaining the consent of the other party to do or to abstain from doing the act.
- (vii) offer should not impose an unnecessary obligation to communicate non acceptance.

Acceptance

Section 9(b) defines acceptance as "When the person to whom an offer is made signifies his assent thereto the proposal is said to be accepted, A proposal when accepted become a promise

Essentials of a valid acceptance:-

- (i) Acceptance must be absolute and unqualified.
- (ii) Acceptance must be communicated.

- (*) Acceptance must be given in a prescribed or reasonable mode
- (*) Acceptance must be given within a reasonable time and before the offer lapses
- (*) Acceptance cannot precede an offer
- (*) Acceptance must be given only by the person to whom the offer is made
- (*) Revocation of acceptance

Void & Voidable Agreements

- (*) Voidable Contract :- An agreement which is enforceable by law at the option of one or more parties thereto but not at the option of other is a voidable contract.
- (*) Void agreement : An Agreement not enforceable by law is said to be a void agreement. A void agreement does not create any legal rights or obligation; hence it is null and void ab initio.
- (*) Void Contract : A contract which ceases to be enforceable by law becomes void when it ceases to be enforceable by law. Void contract is initially a perfectly valid contract but subsequent development turns it into a void contract.

(✓) The following agreements have been expressly declared to be void by the Indian Contract Act:

- (*) Agreement by a minor or a person of unsound mind
- (*) Agreement of which the consideration or object is unlawful
- (*) Agreement made under a bilateral mistake of fact material to the agreement.
- (*) Agreement made without consideration.
- (*) Agreement made without consideration
- (*) Agreement contingent on impossible events
- (*) Agreement to do impossible acts.

Legality of object & Consideration :-

- (*) Section 25 of the Indian Contract Act provides that "An agreement made without consideration is void".
- (*) The reason why law enforces only these promises which are made consideration is that gratuitous or voluntary promises are often made rashly and without due deliberation. To prevent the parties seeking legal resource for dispute arising due to non-fulfillment of such rash contractual obligations which lack consideration, it is essential to put consideration as one of the essential element in order to be construed as a binding contract.

(★) Legal Rules Regarding Consideration:

- (*) Consideration must move at the desire of the promisor.

- (*) Consideration may move from the promisee or any other person.
- (*) Consideration must be something of value.
- (*) It may be an act, abstinence or forbearance or a return promise.
- (*) It may be past, present or future which the promisor is already not bound to do.
- (*) It must not be unlawful.

Stranger to Contract / Doctrine of privity of Contract:

- (*) The doctrine of privities of Contract means that a contract is between the parties only and no third person can ~~are~~ sue upon it.
- (*) It means that a stranger to contract cannot sue upon it. The law in India is the same as the English law.
- (*) According to the Indian Contract Act, Consideration for an agreement may proceed from a third party, but the third party who is a stranger to the agreement cannot sue on the agreement.
- (*) A person who is a party to the contract alone can enforce the legal rights arising there from. So a stranger to contract ~~are~~ ~~the~~ as a rule, cannot sue upon the Contract.
- (*) The following are the exceptions to the rule

that a stranger to a contract cannot sue:

- (1) Beneficiary of a trust.
- (2) Provision in marriage settlement.
- (3) Provision for maintenance or marriage expenses of female members under a family arrangement.
- (4) Assignee of a contract.
- (5) Acknowledgement of liability.
- (6) Agency contract.

Capacity of parties :- As per section 11 every person is competent who is of the age of majority and who is of sound mind, and is not disqualified from contracting by any law to which he is subject. The following types of persons are not competent to contract -

- (a) A person who has not attained the age of majority, i.e. minor.
- (b) A person of unsound mind.
- (c) A person who is disqualified from contracting by some law.

MINOR

As per section 3 of the Indian Majority Act of 1875, every person in India is a minor if he has not attained the age of 18 years of age. An agreement with a minor is void ab initio. He cannot be held liable on an agreement on the ground that, since earlier he had attained major-

city. Minority is a personal privilege and a minor can take advantage of it and bind other parties. A minor can be appointed an agent, but he is not personally liable for any of his acts.

Sound Mind Person -

(Sec. 12) A person is said to be of sound mind for the purpose of making a contract if at the time when he makes it, he is capable of understanding it and of forming a rational judgment as to its effect upon his interests. A person who is usually of unsound mind, but occasionally of sound mind, may make a contract when he is of sound mind. A person who is usually of sound mind, but occasionally of unsound mind, may not make a contract when he is of unsound mind.

Other Disqualified Persons :-

- (*) An agreement with an alien Enemy is void.
- (*) Foreign sovereigns and their representatives cannot enter into contract except through their agents residing in India.
- (*) A Convict cannot enter into a contract while he is undergoing imprisonment.
- (*) An insolvent person cannot enter into any contract.
- (*) Drunken or intoxicated person cannot enter into

valid contracts while such drunkenness lasts.

FREE CONSENT →

'Two or more persons are said to consent when they agree upon the same thing in the same sense' - [sec 13]

As per section 14 of the Contract act consent is said to be free when it is not caused by -

- (1) Coercion (sec 15), or
- (2) Undue influence (sec 16), or
- (3) fraud (sec 17), or
- (4) Misrepresentation (sec 18), or
- (5) Mistake, subject to provisions of sec 20, 21, and 22

COERCION [sec 15] -

The term has been defined in section 15 of the act as "Coercion" is the committing or threatening to commit, any act forbidden by the Indian Penal Code (45 of 1860), or the unlawful detaining or threatening to detain, any property, to the prejudice of any person whatever, with the intention of causing any person to enter into an agreement. If a person unlawfully detains or give a threat to detain any property to the prejudice of any person whatever with the intention of causing any person to enter into an agreement amount to coercion.

Effect of Coercion :-

According to section 19 when the consent is caused by coercion, fraud, misrepresentation, the agreement is voidable at the option of the party whose consent was so caused. The aggrieved party may opt to rescind the Contract. If the aggrieved party seeks to rescind the Contract he must restore the benefits so obtained under the contract from other party.

* It should be noted that threat to commit suicide also amounts to coercion.

UNDUE INFLUENCE [Sec-16] → Section 16 of the Indian Contract Act defines influence as:-
A contract is said to be induced by "undue influence" where - the real relations subsisting between the parties are such that one of the parties is in a position to dominate the will of the other and uses that position to obtain an unfair advantage over the other.

Effect of undue Influence ÷ Section 19A provides that when the consent is caused by undue influence, the agreement is voidable at the option of the party whose consent was so caused. The aggrieved party may opt to rescind the Contract. If the aggrieved party seeks to rescind the Contract he must restore the benefit so obtained under

the Contract from other party.

FRAUD [sec 17]

As per section 17 of the Contract Act -
"fraud" means and includes any of the following acts committed by a party to a contract, or with his connivance, or by his agent, with intent to deceive another party thereto or his agent, or to induce him to enter into the contract.

Explanation to section 17 of the Indian Contract Act provides that mere silence as to facts likely to affect the willingness of a person to enter into a contract is not fraud unless the circumstances of case are such that having regard to them it is the duty of the person keeping silence to speak or unless silence itself is equivalent to speech.

In the following two types of cases, silence amounts to fraud, as held by the courts in various cases:

(a) where there is change in circumstances.

(b) when there is half-truth

(c) Effect of fraud: According to section 19 when consent to an agreement

is caused by coercion, fraud or misrepresentation.

The agreement is a contract voidable at the option

of the party whose

(d) Consent was so caused

Misrepresentation [Sec 18] -

A statement of fact which one party makes in the course of negotiation with a view to inducing the other party to enter into a contract is known as misrepresentation. It must relate to some fact which is material to the contract. It may be expressed by words spoken or written or implied from the acts and conduct of the parties.

A representation when wrongly made either innocently or intentionally is a misrepresentation. When it is made innocently or unintentionally it is misrepresentation and when made intentionally or willfully it is fraud.

Effect of Misrepresentation:

As per section 19 when consent to an agreement is caused by misrepresentation the agreement is a contract avoidable at the option of the party whose consent was so caused. A party to a contract, whose consent was caused by misrepresentation, may, if he thinks fit, insist that the contract shall be performed, and that he shall be put in the position in which he would have been, if the representations made had been true.

Mistake: [Sec. 20, 21 and 22] - Mistake means an erroneous belief